

Date

ROUTING AND TRANSMITTAL SLIP

18 APR 1983

TO: (Name, office symbol, room number,
building, Agency/Post)

Initials

Date

1. C/CAD

BDS 4/21

2.

D # May

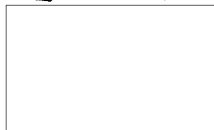
3.

5.

Action	File	Note and Return
Approval	For Clearance	Per Conversation
As Requested	For Correction	Prepare Reply
Circulate	For Your Information	See Me
Comment	Investigate	Signature
Coordination	Justify	

REMARKS

4. Pers retain -

DO NOT use this form as a RECORD of approvals, concurrences, disposals,
clearances, and similar actions

FROM: (Name, org. symbol, Agency/Post)

Room No.—Bldg.

DD/Pers/SP

Phone No.

5041-102

OPTIONAL FORM 41 (Rev. 7-76)

Prescribed by GSA
FPMR (41 CFR) 101-11.206

☆ GPO : 1981 O - 361-529 (148)

Social Security Coverage of Federal Workers—The Real Issues

BY JAMIE COWEN

To whisper the phrase "social security coverage" around most federal employees is to send chills up most of their spines. The picture envisioned is an insatiable money-starved Social Security System gobbling up a reasonably stable federal retirement fund, leaving a skeleton of the current retirement system for its current and future beneficiaries. Not only is that an absurd reflection, but also it obscures the far more fundamental issue of civil service retirement reform.

No proposals to remedy the ills of the Social Security System recommend

Jamie Cowen is Special Counsel, Subcommittee on Civil Service, Post Office and General Services Senate Governmental Affairs Committee.

tapping the Civil Service Retirement Fund for additional monies. The sole economic benefit to the Social Security System is the infusion of new money to its trust fund from additional participants. Since federal employment is not covered by the system, the inclusion of a group of federal employees, whether current or new, will add a new source of revenue to the starving system through the payroll taxes. In the long run, the inclusion of federal workers will have a marginally positive effect upon the social security trust fund balance.¹

The National Commission for Social Security Reform has recommended covering all newly hired federal and postal employees beginning in January of 1984 under the Social Security System. Irrespective of one's position on

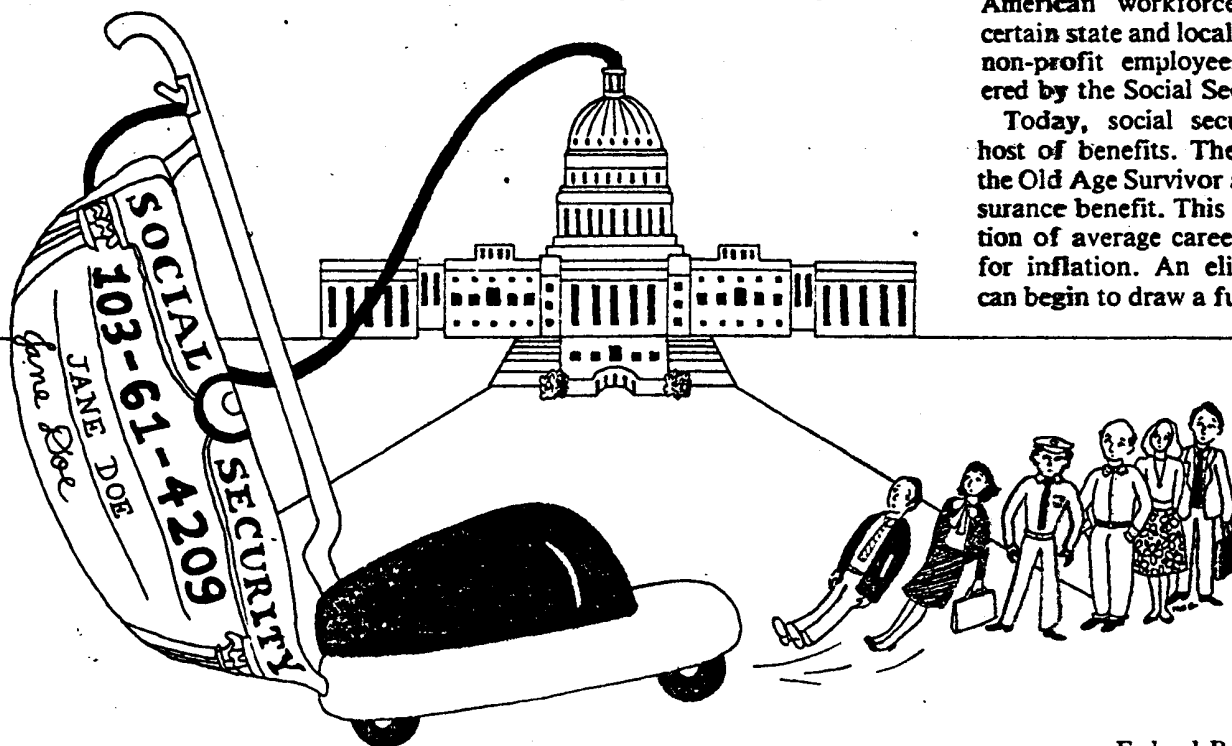
that recommendation, a number of related and more important issues must be considered. The federal workforce needs to be aware of these issues so it can recommend to its representatives how it wants them decided. This article will assume that new federal employees will be covered by social security and thus will focus on relevant issues in developing a new civil service pension plan which will be integrated with social security.

As a caveat, the establishment of a new plan will not in any way affect the financial stability of the current system. Most of the current system's financing results from direct transfers from the general treasury. This will continue regardless of the existence of a new plan.

AN INTRODUCTION TO SOCIAL SECURITY AND CIVIL SERVICE RETIREMENT

The Social Security System was established because of the aging of the American population and the devastation sustained particularly by the elderly during the Depression. It was intended as a social insurance program to replace a worker's lost earnings during retirement. It originally only covered wage earning and salaried workers in commerce and industry. Over the years, however, coverage was extended to approximately 90 percent of the American workforce. Only federal, certain state and local government, and non-profit employees remain uncovered by the Social Security System.²

Today, social security provides a host of benefits. The main benefit is the Old Age Survivor and Disability Insurance benefit. This benefit is a function of average career wages adjusted for inflation. An eligible beneficiary can begin to draw a full old age benefit



at age 65 or a reduced one at age 62. A married beneficiary's spouse and dependent children are entitled to a benefit as well.

The spouse and children can receive one half of the basic benefit while the beneficiary is alive. If the beneficiary is dead and the spouse is of retirement age or has dependent children, the spouse is entitled to 100% of the benefit; children are entitled to 75%. Disability benefits are similar to the basic benefits except the family benefit is usually somewhat less.

Table I¹ is a rough example of the basic benefit for three individual employees who retire at different salary levels. The family benefit would be added to this.

TABLE I

Employee:	A	B	C
Final Year's Salary:	\$15,000	\$30,000	\$45,000
Social Security Benefit:	\$ 6,000	\$ 8,200	\$ 8,400

Fifteen years prior to the enactment of the Social Security Act, the Civil Service Retirement System (CSRS) was established. Unlike the intent underlying the establishment of the Social Security System, CSRS was established to retire extremely old civil servants to enable younger ones to move through the ranks.⁴

The original act provided for mandatory retirement at age 70. The benefit was computed as a percentage of the employee's average salary for his last ten years of service. Only disabled employees could retire with a benefit before age 70 if they had served fifteen years.

Today, retirement eligibility for most federal employees is age 55 with 30 years of service, age 60 with 20 years of service, and age 62 with 5 years of service. The benefit is calculated as a percentage of one's high three years of salary.

Benefits under both systems have substantially increased since the enactment of these separate acts. Still, though, the purposes of each act and their effect on employees are very different. Social security payments were always intended to provide the elderly with a base of income. There are two components to these payments.

The social security benefit was in-

tended, and does to some extent, to bear a direct relationship to earnings over a worker's career. In other words, the higher the earnings (up to a point) the greater the benefit. On the other hand, it also redistributes wealth from the higher income to the lower income to ensure a minimum standard of living. Therefore, while the higher income still receives back more in a benefit than the lower income, the higher income receives a lower percentage of salary. Thus, the Social Security System assumes the dual role of an economic and social program.

The Civil Service Retirement System very simply replaces a certain percentage of an employee's preretirement earnings at all income levels. To give an example of how the two systems treat the same employee, assume Employees A, B, and C work for 30 years and retire at different salary levels. Table II¹ is a rough calculation of how the two systems replace earnings.

TABLE II

Employee:	A	B	C
Final Year's Salary:	\$15,000	\$30,000	\$45,000
Civil Service Benefit:	\$ 8,000	\$16,200	\$24,300
	(54%)	(54%)	(54%)
Social Security Benefit:	\$ 6,000	\$ 8,200	\$ 8,400
	(40%)	(27%)	(19%)

Note that Employee C receives a greater dollar amount than Employee A in social security benefits. However, as a proportion of his final salary, Employee C receives far less. This exemplifies the redistributive nature of the Social Security System. The same employees under the Civil Service System, though, receive the same percentage of preretirement earnings regardless of salary level.

The different treatment of employees can be attributed to the different nature of the systems. Again, the Social Security System is in part a social insurance program, while the Civil Service Retirement System is in reality a form of deferred compensation. Thus, the government, as an employer through the Civil Service System, treats all of its employees similarly—each will receive a certain percentage of his salary at retirement. This does not mean, though, that the systems are mutually exclusive.

INTEGRATING SOCIAL SECURITY WITH A CIVIL SERVICE PENSION

During consideration of the original Social Security Act, one of the more controversial issues was the question of covering employers who already offered a pension plan for their employees. It was ultimately decided that since



pensions varied so greatly, even within a particular business, and since so many of them were wiped out during the Depression, these employers should indeed be covered.⁶ These factors obviously did not apply to the Civil Service Retirement System and thus federal employment remained outside of the Act.

At that time, there were approximately 750 pension plans in operation. Now, there are 696,000⁷. Most of them are integrated with social security. In other words, social security serves as the base for most pension programs in the nation.

The dilemma for employers, and soon the government, is how to integrate their pension plans with a social security program whose aim is somewhat different. Employers are usually concerned about employee turnover, age of retirement, and rewarding long term employees. Retirement benefits are viewed as deferred compensation and hence bear a direct relationship to earnings. Social security's social policy of redistributing income to the lower income conflicts in part with the underlying policy of employers' pension programs.

Thus, most employers compensate for the redistributive nature of the social security benefit, in a sense, by redistributing the pension in the opposite direction. Table III⁸ is an example where the pension benefit simply overlays the social security benefit with no integration.

TABLE III

Employee:	A	B	C
Final Year's Salary:	\$15,000	\$30,000	\$45,000
Social Security Benefit:	\$ 6,000	\$ 8,200	\$ 8,400
Pension Benefit (1.5% times service):	\$ 6,100	\$12,200	\$18,200
Total Income:	\$12,100 (80%)	\$20,400 (68%)	\$26,600 (55%)

Note that without integrating the retirement benefit with the social security benefit, Employee A receives a far greater proportional benefit than Employee C.

As an alternative, the pension benefit can recognize the level of the social security benefit and offset it to some degree.⁹ This is the approach most often used in the private sector. In Table IV¹⁰ the pension benefit is reduced by one half of the amount of the social security benefit.

TABLE IV

Employee:	A	B	C
Final Year's Salary:	\$15,000	\$30,000	\$45,000
Social Security Benefit:	\$ 6,000	\$ 8,200	\$ 8,400
Pension Benefits Gross (2% times service):	\$ 8,100	\$16,200	\$24,300
Half Social Security:	\$ 3,000	\$ 4,100	\$ 4,200
Net Benefit:	\$ 5,100	\$12,100	\$20,100
Total Income (Pension and Social Security):	\$11,100 (74%)	\$20,300 (68%)	\$28,500 (63%)

Note that while Employee C is still receiving a lower percentage of his final salary than Employee A, the difference is not as great as the example shown in Table III. In this case, Employee A's pension benefit is smaller as a percentage of salary than Employee C's. This offsets the opposite effect of the social security benefit. Again, the reason for doing this is to treat retirement as deferred compensation and thus align employees' benefits more closely to salary.

As legislation is likely to be considered later this year to provide a supplemental pension for federal workers covered by social security, the question of how to apportion the pension benefit will be critical. Should the government plan compensate for social security's redistributive formula as most private plans do, or should the government as employer and policymaker be consistent and maintain the redistributive tilt in the pension plan? Notwithstanding the requirements in the Tax Code spelled out in note nine, Congress could completely offset the skew in the social security benefit and replace a straight level percentage of salary such as CSRS.

One other factor to consider is that any offset in a pension plan could negatively impact the lower income if an option exists for early retirement. Recall that a pension designed to offset the redistributive bias of the social security benefit is skewed in the opposite direction. If entitlement to that pension benefit is available prior to the social security age, a lower income worker may receive a smaller percentage of salary than a higher income employee until social security payments begin.

DEFINED BENEFIT VERSUS DEFINED CONTRIBUTION

The Social Security and Civil Service Retirement Systems are retirement plans known as defined benefit plans. Both systems promise a certain benefit calculated as a percentage of salary and in some measure are dependent upon length of service.

There is another common retirement plan known as a defined contribution plan. In this case, the employer, and occasionally the employee as well, contributes a specified percentage of salary to an employee account in a trust fund which is then invested in various types of interest-bearing instruments. The employee's retirement benefit consists of the accumulated contributions in his account plus their earnings over time.

In such a case, an arrangement is normally made with a retiring employee to transform his account into a lifetime annuity. The amount of the annuity is determined by the employee's projected mortality, the amount of money currently held in his account, and the expected returns that the account will continue to earn while it is being disbursed.

Both types of retirement plans, defined benefit and defined contribution, have certain advantages and disadvantages. The decision as to which plan will serve as the new civil service pension is probably the most significant issue facing the federal workforce.

Defined benefit plans are more prevalent in older, unionized industries. In recent years, however, contribution plans have been used more frequently.¹¹ The more frequent use of contribution plans can be attributed to the tax advantages afforded to employers through the use of modified contribution plans, and to difficult economic times.

For a government system, obviously, the tax treatment of a plan is immaterial. However, the impact on the federal budget of an unpredictable and expensive defined benefit plan is what is causing the current attack on the Civil Service Retirement System and thus is important when consideration is being given to devising a new government plan.

The most significant difference between a benefit and a contribution plan is in the security or certainty of the benefit.¹² A benefit plan promises a specific benefit regardless of the economic climate. Poor economic condi-

tions do not affect that benefit especially if, as in the case of the Civil Service Retirement System, the benefit is adjusted for inflation. In a sense, the government bears the risks and the cost of an inflation-adjusted defined benefit plan.

An important caveat to this is the assumption that during difficult economic times an employer will not reduce the level of benefits under a defined benefit plan. ERISA prohibits reductions in benefits once employees are vested.¹³ ERISA does not cover the Civil Service Retirement System, though, and thus changes are not prohibited. For example, Congress has reduced benefit levels often in recent years. In fact, it is unlikely that a government benefit plan can ever be fully insulated from subsequent acts of Congress.

In a contribution plan, the employee owns the account and thus the risk falls on the employee. If investments do well, the employee's account gains. Obviously, the reverse is equally true. Rather than providing for a certain benefit, a contribution plan ensures a certain cost which is advantageous to the employer. A well invested contribution plan, though, can provide employees with good benefits while not increasing the cost to the employer.

The certainty for the employee is through the ownership of the account. Normally, annual statements are provided to the employees showing their accumulations. These account statements keep the employees involved in their own retirement planning and assist them in determining when they could feasibly retire.¹⁴

In most situations, however, the benefit plan provides certainty for the employee while the contribution plan provides the same for the employer.

The greatest advantage of a contribution plan is its portability features. Because an employee in a sense owns his account, when he leaves employment most plans permit the employee to take his account with him, allowing the employee to roll over the amount into an IRA and thus to continue to receive investment growth from those contributions. In other words, he loses nothing by changing jobs. This provides the employee with a great deal of flexibility in his career planning.

Most benefit plans in effect penalize less than full career employees. A departing employee rarely can take any benefit with him. Instead, if he is vested he is entitled to receive the benefit at

retirement age. However, the benefit is not adjusted for inflation after he leaves employment, at least not until he begins receiving the benefit. Thus, the real level of the benefit will be greatly reduced due to the intervening period.

The Civil Service Retirement System is a case in point:

"Even the federal government, which is in most respects exceptionally liberal in paying benefits to its retired employees, excludes vested terminated employees from inflation protection. They are barred from cost-of-living increases between their time of departure from federal employment until retirement at age sixty-two. Although those terminating from federal employment can withdraw their account balances (their own contributions with little or no interest), they cannot roll them over into IRAs. This ungenerous policy has kept the federal government filled with disgruntled employees



who know the exact day they are eligible to retire. Their situation is worse than that of private employees for whom Social Security continues to be indexed even if they change jobs. Many would look for another job if they could afford to leave, but the necessary sacrifice of their retirement security makes such an option impossible."¹⁵

Another important factor to consider is the entry age of an employee into the plan. A contribution plan is more advantageous for an employee beginning his job at a relatively young age. This gives his account time to accumulate contributions and to take advantage of compounding interest.¹⁶ For example, an early participant in the Teacher's Insurance and Annuity Association and College Retirement Equities Fund, the nation's largest defined contribution plan, would have seen his 1952 stock unit valued at \$10.50 increase to \$120.00 today when the compounding effect is considered.

For an employee who joins a new employer at middle age, the defined

benefit plan is better.¹⁷ As noted previously, the employee will receive a specified benefit which is not dependent upon accumulating contributions. Obviously, the account in a contribution plan of an older entry employee will not have sufficient time to fully accumulate unless the employee is permitted to roll over a cashed out account of another plan into his present one.

For employees who plan to work beyond retirement age, the contribution plan will be more attractive.¹⁸ While benefits under both types of plans increase as one works longer, the rate of increase in benefits under a contribution plan accelerates in later years due to the compounding phenomenon.

Finally, the better plan to hedge against inflation after retirement will depend upon the extent of the cost-of-living adjustment available in a defined benefit plan. In most cases, in the private sector, a contribution plan more adequately protects against inflation than a benefit plan. Even while being disbursed through an annuity, the account in a contribution plan is being re-invested. Thus, the earnings on the disbursing account can be used to provide inflationary protection.

Very few defined benefit plans in the private sector incorporate automatic cost-of-living adjustments. Those that do cap the adjustments at three or four percent. Most companies will provide cost-of-living adjustments on an ad hoc basis depending on the companies' ability to pay for them.¹⁹ The lack of any regular adjustment in private plans, though, must be seen in light of the fact that these same employees receive social security benefits which are adjusted for inflation.

If a cost-of-living adjustment is included in a plan which is comparable to that provided for in the Civil Service Retirement System, the benefit plan would clearly be preferable. However, note that the full and automatic cost-of-living adjustments currently applied to federal retirement programs is one of the budgetary items most under attack. It may be very difficult to establish a new pension system with that feature during the current economic climate.

Towards the end of the 97th Congress, Senator Ted Stevens (R-AK), Chairman of the Subcommittee on Civil Service, Post Office, and General Services of the Senate Governmental Affairs Committee, introduced legislation establishing a new supplemental

civil service pension plan integrated with Social Security System. The 905,²⁰ would establish a three-employment program for new federal employees with an option for current employees to join.

The main pension is a defined contribution plan. In addition to the significant change to a contribution plan from the current civil service benefit plan, the legislation authorizes gradual private investment of employee accounts. The bill has not yet been reintroduced in the 98th Congress.

One of the Chairman's motives behind the legislation is to put the Civil Service Retirement System on the same footing as private plans in that once an employee is vested, the system's benefits cannot be subsequently reduced for that individual. As was noted previously, ERISA prohibits changes in a private plan's design which would result in a reduction of benefits for a vested employee. Since the government is the employer in the Civil Service Retirement System, such protection is nonexistent since one Congress cannot bind another Congress from subsequent action.

Quoting from a report on the Stevens bill:

"The courts have consistently upheld Congress' authority to modify government pensions. The Supreme Court has held that a pension granted by the federal government confers no rights which cannot be 'revised, modified or recalled' by subsequent legislation. Additionally, the court has ruled that until a pension is due, an employee's right is not contractual but a mere expectancy which can be revoked at any time. Hence, there is little certainty in the current system."²¹

Apparently, the Senator is arguing that the normal security and certainty of a defined benefit plan is actually not available in a government plan. He contends that the inherent nature of a contribution plan actually affords more security than a benefit plan in a governmental setting since an employee's account in a contribution plan could not be tampered with due to the employee's ownership of the account.

Private investment of the government contributions strengthens the ownership premise of the accounts and hence the security of the system according to Stevens.

"Any private investment would

enhance the contractual nature of the pension system. Although we agree that a property right devolves from the nature of a defined contribution plan, even if the money is invested solely in government securities, distributing employee monies through various private firms and into the economy strengthens the contractual and property concepts. The government would no longer be guaranteeing a benefit: not only would that be strong grounds for considering the employee's account sacrosanct, but any private investment would assure that accumulated contributions plus investment earnings could not even be reached by government action."²²

A government contribution plan still places the risk of investment performance on the employees, but the ability of the government to be able to subsequently reduce benefit levels in a benefit plan (most likely to occur during difficult economic times) diminishes the normal security of the benefit plan.

Clearly, the biggest issue facing the federal workforce vis-a-vis a new pension system is whether the design should be a traditional benefit plan or a contribution plan. A contribution plan offers more variation and flexibility; a benefit plan more security and certainty. One possibility is a hybrid system—a minimum benefit plan with a contribution plan design so as to afford protection against a disaster while providing the many opportunities available through a contribution plan.²³

SUPPLEMENTS TO THE BASIC PENSION

Many employers offer a variety of additional benefits to further supplement their basic pension. Normally, these benefits are offered on a voluntary arrangement. Typical supplements are thrift plans, stock options, profit sharing, and deferred compensation plans.²⁴

The government, as an employer, is obviously limited in what it can offer. However, that should not preclude it from availing itself of certain opportunities. In fact, two government agencies, the Federal Reserve Board and the Tennessee Valley Authority, offer thrift plan participation to their employees.

A thrift or savings plan is a vehicle to

encourage savings, and thereby increase retirement income, by an employee which is rewarded by an employer matching contribution. Often, the employer arranges for employee loans from the thrift plan for the purchase of a home or a college education.

Again, the Stevens bill incorporates this concept. It allows an employee to contribute up to sixteen percent of pay with the government to match the first three percent. Under the Stevens proposal, the thrift plan overlays a defined contribution plan. Under the Reserve Board and TVA systems, the thrift plan overlays a defined benefit package.

In addition, the Internal Revenue Service recently issued regulations providing for what is called deferred compensation.²⁵ Deferred compensation allows an employee to set aside for retirement a portion of his salary thereby avoiding tax liability on that amount of salary until he receives it back at retirement age. Interest earned on that compensation is also sheltered from taxes until the employee begins to receive it back.

Finally, with the availability of Individual Retirement Accounts (IRAs), employees already have an additional option for retirement. IRAs, however, do not proportionately benefit the lower income. Their greatest asset is their tax shelter, which obviously benefits the higher income more than the low.

A whole variety of new retirement tools have sprung up in recent years. Since a new federal pension plan will probably need to be developed, careful consideration should be given to providing some of these options.

BUYING OUT CURRENT EMPLOYEES

The last subject to be discussed in this article is what is termed a buyout option. Although presumably any legislation establishing a new federal retirement program will be designed for new employees, current employees should ensure that an option exists for them to join it. Since the current workforce will be the ones assisting in the new program's development, they should further ensure that the option to join the new program is attractive.

Presumably, a new plan will have certain advantages and disadvantages over the current retirement system. Many current federal employees may find the advantages of participation in the new system to be appealing. Assur-

edly, those developing the new legislation will find it in their interests to lure current federal employees to join. An attractive buyout option can meet both interests.

In 1980, a new retirement system was established for new employees of the State of Maryland.²⁴ The impetus behind the development of the new system was the increasing cost of the old one. Prior to the establishment of the new system, state employees participated in a full state retirement system plus social security. The combined benefits under both systems were extremely good and very costly.²⁵

The new system was integrated with social security and in effect, while reducing overall employee contributions, the eventual retirement benefits were significantly reduced. However, an attractive buyout option was provided to current employees. For those joining the new system, service in the old system was automatically credited to the new one, plus a substantial refund of previous employee contributions with interest was provided to current employees.

While current employees were fully apprised of the reduction in benefits they were opting to receive by virtue of transferring systems, many were eager to receive the refund of previous contributions. Over thirty percent of the current workforce transferred.²⁶

The Stevens bill also provides a lucrative buyout option for current federal employees. Because an employee would be transferring from a defined benefit to a defined contribution plan, the options are more complex. Actually, the Stevens legislation affords employees two buyout options.

"In the first option, the government would match dollar for dollar the employee's total contributions to the current system, and apply a factor of five percent to represent interest compounded for all of his years of employment. This sum would be transferred to the new system.

"In the second option, the present value of accumulated future benefits is computed, using an inflation factor of six percent. As in the first option, this new sum would be transferred to the new system to the employee's account. The first option is more beneficial to those with less than about thirteen years of service; the second option is more beneficial to work-

ers with service greater than thirteen years. Here's an example:

"Assume an employee entered government at age 25 with a starting salary of \$10,000 and received annual pay increases of six percent. At age 30 the first option would yield him \$9,100; the second option, \$4,400. At age 45 the first option would yield him \$81,400; the second option, \$125,000."²⁷

In either case, according to the Committee's report, many federal workers will find it advantageous to transfer to the new system due to the sizeable lump sum contributions made to their accounts. An attractive feature of the Stevens bill permits employees to leave government and withdraw their account after participating in the new system for five years. This could be very appealing to current employees considering leaving government in the near future.

Developing and passing legislation that establishes a new civil service pension system will be a monumental task. The federal workforce needs to be involved in this process. As can be seen from this article, the decisions to be made will have far-reaching effects not only on the retirement plans of the workforce but on the future makeup of the workforce itself. It will also have reverberations throughout the pension field, possibly serving as a model or at least influencing other pension systems.

Federal employees must direct their efforts where they will be most effective. Developing a new pension system integrated with social security is the task at hand.

FOOTNOTES

¹ Report of the National Commission on Social Security Reform, January, 1983, pp. 2-5.

²Schieber, Sylvester, *Social Security: Perspectives on Preserving the System*, (Washington, D.C.: Employee Benefit Research Institute, 1982), pp. 17-19.

³Hustead, Edwin, Hay Associates.

⁴Congressional Research Service, *Restructuring the Civil Service Retirement System: Analysis of Options to Control Costs and Maintain Retirement Income Security* (Washington, D.C.: U.S. Government Printing Office, 1982), pp. 7-9.

⁵Hustead, Edwin, Hay Associates.

⁶Schieber pp. 14-16.

⁷*Ibid*, p. 47.

⁸Hustead, Edwin, Hay Associates.

⁹Section 401 of the Internal Revenue

Code of 1954 prohibits an employer's pension from fully offsetting the redistributive formula in the social security benefit. It does allow the social security benefit to be partially offset, however.

¹⁰Hustead, Edwin, Hay Associates.

¹¹Schieber, pp. 46-54.

¹²Charles Lombert Trowbridge, "Defined Benefit and Defined Contribution Plans: An Overview," in Dallas L. Salisbury (ed.), *Economic Survival in Retirement: Which Pension Is For You?*, (Washington, D.C.: Employee Benefit Research Institute, 1982) pp. 4-7.

¹³§203 of the Employee Retirement Income Security Act. The Act covers all private employees who offers pensions.

¹⁴William C. Greenough, Speech to the Conference on the Design Restructure of Public Pensions In An ERA of Financial Distress sponsored by Edward H. Friend and Company, Washington, D.C., 1982.

¹⁵Edith V. Fierst, "Defined Benefit and Defined Contribution Plans: A Participant's Perspective," *Economic Survival in Retirement: Which Pension Is For You?* pp. 93-94.

¹⁶*Ibid*, p. 90.

¹⁷*Ibid*, p. 90-91.

¹⁸*Ibid*, p. 92.

¹⁹*Ibid*, pp. 92-93.

²⁰Introduced in the U.S. Senate on September 14, 1982.

²¹Subcommittee on Civil Service, Post Office and General Services of the Committee on Governmental Affairs, United States Senate, *Civil Service Pension Reform Act*, (Washington, D.C.: U.S. Government Printing Office, 1983), p. 8.

²²*Ibid*, p. 16.

²³Trowbridge, p. 22.

²⁴Schieber, pp. 62-66.

²⁵§1.401(K) of the regulations under the Internal Revenue Code of 1954.

²⁶Article 73B, Section 111, Annotated Code of Maryland.

²⁷Pension Study Committee, Report to the 1978 Session of the Maryland General Assembly, p. X.



U.S. Reports on microfiche. Reduce \$9000 and 90' of shelf space to \$900 and 1' by ordering U.S. Reports on microfiche. Now available for \$2.00 per volume from U.S. MicroLaw, Inc., 918 F Street, N.W., Suite 312, Dept. B, Washington, D.C. 20004 or call: (202) 638-6455.

FEDERAL BAR ASSOCIATION

Announcing...

officially sponsored

Personal Accident Insurance Plan

According to the National Safety Council, each year nearly 10 million people are involved in accidents causing death, disability and severe trauma. And accidents affect ALL persons young and old...friends...neighbors...family...and even you.

The Federal Bar Association now sponsors one of the most realistic accident insurance plans ever designed to aid in financial protection from the ever-present threat of an accident. The new FBA Personal Accident Insurance Plan offers the individual member as well as full family coverage for up to a chosen benefit of \$300,000.00, \$200,000.00, \$100,000.00 or \$50,000.00.

This Plan offers up to \$300,000.00 in accidental death benefits for loss of life and a schedule of benefits for accidental dismemberment or permanent impairment in the event of

the loss of the normal everyday use of your eyes or limbs. The scheduled benefits can be as high as \$300,000. Since your professional responsibilities depend upon your ability to communicate, you are also covered with up to 100% of your chosen benefits for the loss of your speech or hearing.

You are guaranteed coverage if under age 70. You can also enroll your spouse, if under age 70, and all unmarried dependent children, age 14 days to 19 years (full-time student to age 23) in the FULL FAMILY coverage. That way you and your family can be insured for financial protection from accidents at any time and any place.

If you are interested in receiving more information concerning this program send in for a brochure and enrollment form on the new Federal Bar Association sponsored Personal Accident Insurance Plan today!



Please send me all the details on the new Federal Bar Association sponsored Personal Accident Insurance Plan.
(Please print)

Name _____

Address _____

City _____ State _____ Zip _____

Mail completed coupon today to: Albert H. Wohlers & Co.,
Administrator
FBA GROUP INSURANCE PLANS
1500 Higgins Road
Park Ridge, Illinois 60068

13 MAY 1983

SOCIAL SECURITY COVERAGE FOR CIA
EMPLOYEES ENTERING ON DUTY ON OR AFTER 1 JANUARY 1984

This paper is directed at the impact of Social Security coverage of new Agency employees as of 1 January 1984, with particular focus on the adverse effect of this coverage on the ability of CIA management to recruit and maintain the quality of work force essential to the effective performance of the Agency's mission.

The impacts that are cited are limited to those relative to Social Security coverage; they do not include the more imminent problems that would be experienced should proposals for changing the provisions of Civil Service and other civilian federal retirement systems be enacted.

25X1

SECRET

~~SECRET~~

SOCIAL SECURITY COVERAGE FOR CIA
EMPLOYEES ENTERING ON DUTY ON OR AFTER 1 JANUARY 1984

REFERENCE: Social Security Amendments of 1983

I. Background

The recently enacted Social Security Amendments of 1983 include the provision that all new federal employees hired as of 1 January 1984 will be covered under Social Security. This Social Security legislation also provides covered new hires as of 1 January 1984 with eligibility to participate in current civilian federal retirement systems. Such participation would be authorized until new legislation is enacted instituting a supplemental retirement system for these new employees. This "bridging" authority may prove to be of relatively short duration, because the supplemental retirement plan legislation is expected to be introduced in the immediate future and could be in place prior to 1 January 1984. The details of this supplemental plan have not been made available, nor has the Administration introduced any legislation on the array of other retirement related changes proposed in the President's FY 1984 Budget.

In recent testimony before the Senate Finance Committee, the Director of the Office of Personnel Management stated that the employee cost for the supplemental plan would be 5.6% of salary. Since the intent of the new retirement plan is to supplement Social Security benefits at retirement, it will provide considerably reduced annuities as compared to current retirement systems and full benefit pay-offs will begin at the same age (now 65) as Social Security.

It must further be expected that, like Social Security, there will be some form of early retirement option available to employees, but that severe reduction penalties of the annuity will be applied.

II. General Effects Produced by Social Security Coverage of New Federal Employees

The primary effects of the new Social Security legislation and the effort to establish some form of reduced benefit supplemental retirement plan will be to:

A. Essentially eliminate early retirement by employees who decide to spend a working career in federal service; retirement will normally be at 65 years of age or later, with 35 to 40 years of service for full annuities.

B. Establish the portability of Social Security coverage from federal employment to private sector careers. The experience and training gained at government expense will greatly stimulate movement of mid-level and younger employees from federal service to nongovernment competitors offering higher salaries and more attractive retirement plans.

SECRET

~~SECRET~~

C. Sharply increase the salary deductions of new recruits for retirement related coverage from the current 7% (9% in 1984 and 11% in 1985 if the President's FY 1984 Budget proposals are enacted) to 11.3% for Social Security/supplemental plan or 12.7% for Social Security and interim regular Civil Service coverage in the event the supplemental plan is not enacted. This would rise to 14.7% in 1984 and 16.7% in 1985 if current proposals prevail.

Social Security coverage of Agency employees and the effects cited above are viewed with considerable concern by CIA management as serious impediments to the support of the President's efforts to revitalize and enhance the Agency's intelligence capability and product.

III. Early Retirement as a Management Tool in the CIA

The CIA has a long established policy which encourages employees to retire at ages substantially earlier than elsewhere in government. The average retirement age in CIA in 1982 was 56.9 under Civil Service and 52.8 under the Central Intelligence Agency Retirement and Disability System (CIARDS).

This policy has been based on recognition that the Agency's vital missions require that the corps of careerists perform their operational, analytical or support duties with sustained high motivation and undiminished effectiveness from their initial entry assignment throughout a preferably brief career of 20 to 30 years. The early retirement provisions of the Civil Service Retirement and CIARDS systems have served the Agency exceedingly well to attract new recruits, provide timely career progression, and encourage retirement of personnel when Agency management prefers that they retire. Extension of the retirement age for full annuities would seriously impair the ability of Agency management to maintain the employee flow-through which is essential to maintaining maximum effectiveness in meeting requirements.

The predictability of early retirement has provided Agency management with the ability to offer our personnel essential developmental assignments and promotion within reasonable time frames to reward excellence of performance. The institution of retirement changes whereby full benefits would not accrue until age 65 would impose prohibitive penalties for early retirement and result in extreme blockages both as regards developmental assignments, promotion headroom, and the resultant extension of service of large numbers of employees well beyond their currency in the state-of-the-art in substantive areas and their capacity to handle the milieu of clandestine operations.

The specific impacts of Social Security coverage of new employees on the CIA as regards recruitment, the extension of retirement age for full annuities and other complications are outlined in the subsequent section.

IV. Impacts of Social Security Coverage of New Employees on the CIA

A. Recruitment of New Employees

1. The Agency recruits approximately new technical and professional employees each calendar year. In spite of numerically high numbers of job seekers in the labor market because of economic conditions, the specific types and caliber of people sought by the Agency are extremely difficult to recruit. Particular problems are encountered in a wide spectrum of high competition areas for critically needed subject and area analysts, computer specialists, advanced scientific and high technology personnel, communications specialists and operations officer trainees.

~~SECRET~~

The majority of the Agency's recruits for experienced professional area experts, economic, political and military intelligence analysts, and scientific and technical analysts are drawn from the ranks of private enterprise and/or academic and research facilities. The inducement to join CIA is made up of a combination of interests in serving the Nation in a vital capacity, the opportunity for a career where their experiences and knowledge will be fully utilized, reasonable compensation, and retirement at a relatively young age permitting a return to academia or other pursuits.

2. The Career Trainee Program, which provides the entry group for young operations officers, must necessarily be highly selective from among the best qualified and most sought after young people from the graduate schools of the Nation. Even with continuous special and concentrated recruitment efforts to attract qualified career officer trainees it is extremely difficult to recruit the types and numbers of these young people that we need to meet our requirements. This difficulty is occurring in spite of the attractiveness of the current Agency career development programs, which offer opportunity for desirable rotational assignments, timely promotion, and the prospects of future retirement with a full annuity under CIARDS at a relatively young age (50) after a minimum of 20 years of service.

3. The Agency's ability to meet its "new hire" requirements will be critically weakened by any dilution of the combined career and benefit "package" currently available. The cost of Social Security coverage and the supplemental retirement system to new employees would total 11.3% of salary, and this could be exacerbated by a possible 12.7% cost for Social Security and interim coverage under current Civil Service. There is no doubt that a sizable increment of qualified and interested young officer candidates would decline employment simply because of these cost factors. An additional number of candidates would lose interest as the prospect of affordable future retirement was extended to age 65.

4. While the option for early retirement can be anticipated within the proposed supplemental retirement plan, we must expect prohibitive annuity reductions for such an election. Early retirees would be faced with a fragmentation of the annuity benefits with a deferral of the full Social Security portion until age 65 (66 in the year 2009 and 67 by the year 2027). An estimated comparison of employee costs, options, and retirement benefits under current Civil Service retirement provisions with those under Social Security and the probable provisions of a supplemental plan are presented in the attachment.

5. The recruitment of both analytical and operational personnel is conducted in a most competitive market. The combined attractiveness of the Agency's current opportunity and benefits package has greatly assisted in offsetting the high cost of living in the Washington area and the relatively low starting salaries (1982 average annual salary was approximately \$23,500) per year for approximately new professionals and technical recruits.

B. The Extension of Retirement Age for Full Annuities and Other Impacts

Mandatory Social Security coverage and the lengthening of service of new Agency employees by up to ten years would create the following problems as regards maintenance of the quality of personnel so essential to meeting our requirements:

SECRET

~~SECRET~~

1. Create severe future blockages in all career paths and seriously impair the ability of Agency management to move promising individuals up through needed rotational and developmental assignments.
2. Essentially dry up promotion headroom in future years as employees defer their retirement to age 65 with 35 to 40 years of service.
3. The CIA Retirement and Disability System was established by law in 1964 in recognition of the special circumstances of service with the Clandestine side of the Agency abroad. This special retirement system offers nonreduced annuities for members (approximately 20 percent of the work force) at age 50 with 20 years of service. The circumstances of frequently dangerous and adverse working and living conditions can lead to early burnout or compromise of personnel carrying out the overseas activities of the Agency. The absence of early retirement incentives for these employees would be severely incompatible with effective staffing of our overseas stations.
4. Personnel who join CIA on or after 1 January 1984 will, under current CIARDS provisions, remain eligible for participation in this system when qualifying conditions are satisfied. The substantial Social Security contributions by both the individual and the Agency will not, however, be recoverable for transfer to the CIARDS fund as are Civil Service Retirement funds under current law.
5. The portability of Social Security coverage, combined with experience and training gained at government expense will stimulate midlevel employee movement to private sector employment.
6. Increased turnover from the ranks of intelligence personnel will make it increasingly difficult to safeguard national security information.

25X1

V. Conclusions and Recommendation

There is no question that Social Security coverage and its provisions for full retirement benefits at age 65 (or later) and reduced benefits at age 62 will present strong disincentives for employees to consider or afford retirement at earlier ages. The proposed supplemental retirement plan provisions for full annuity entitlement must be anticipated as coinciding with Social Security ages for benefits.

The effect of these factors in themselves will deny Agency management a most important tool in recruiting and maintaining the type of work force essential to meeting its requirements.

It is recommended that employees entering on duty with the CIA on or after 1 January 1984 be covered exclusively by a retirement program essentially similar to that currently provided for Agency employees by the Civil Service Retirement and Disability System and by CIARDS. This would necessitate amending CIARDS to encompass all Agency employees, with different provisions and benefits for varying types of service.

~~SECRET~~

COMPARISON OF RETIREMENT OPTIONS AND BENEFITS

Federal Employee Under Current Civil Service with Federal Employee Under Social Security Coverage and Supplemental Retirement Plan

1. BACKGROUND

a. Based upon the assumption that Social Security coverage will be extended to all new federal employees hired as of 1 January 1984, an employee who enters on duty at age 22 in 1984 will be eligible for a reduced Social Security annuity benefit in 40 years (age 62) in the year 2024 and a nonreduced annuity at age 67 in 2029. It is further assumed that by 1 January 1984 all new hires will also participate in a Supplemental Federal Employee retirement plan. This supplemental retirement plan will cost employees 5.6% of salary (per Director of OPM in recent testimony before the Senate Finance Committee). The Social Security system changes coupled with the Administration's plans to introduce legislation to change major provisions of Federal Civilian retirement system, will have a major adverse impact on the Agency's personnel manpower management system.

b. The recruitment of new personnel into the CIA has been greatly facilitated by the promise and predictability of the ultimate retirement benefits and provisions for early retirement without reductions of earned annuities for employees at age 55 with 30 years of service (Civil Service) and for CIARDS at age 50 with 20 years of service.

The Central Intelligence Agency's managerial concerns most certainly include the retention of strong inducements for new professionals to join the Agency in the first place. More importantly to maintain a vigorous, effective and highly motivated work force to meet the stressful demands of intelligence requirements, a retirement system must be retained that will encourage career progression and "flow through" to retirement at fairly early ages after 20 to 30 years of service.

The Administration's proposed retirement system reforms, particularly as regards the extension of nonreduced annuity retirement from 55 to 65 with severe penalties for early retirement will, if enacted, present a different and fragmented dual-source benefit program for new employees.

Early retirement at 55 would still be permitted subject, we must assume, to severe reductions in the earned supplemental annuity with a delay of seven years (i.e. age 62) for a reduced Social Security benefit and ten to twelve years before full Social Security benefits would accrue.

2. COMPARISON OF BENEFITS

A comparison of employee retirement options and benefits under current retirement rules vis-a-vis the proposed Social Security/Supplemental Retirement Plan is needed to determine whether the current retirement provisions proven so useful in the recruitment and future management of new personnel today will be negated should the proposed changes be enacted.

It is not possible to construct an applicable model for the actual options or benefits which may be in being forty years from now, but a useful theoretical comparison can be developed on the basis of the current legal provisions of both Civil Service Retirement and Social Security with some application of the proposed changes that have been announced at this point in time.

COMPARISONS OF RETIREMENT OPTIONS AND BENEFITS

BASED UPON:

- A. Current provisions of Civil Service Retirement.
- B. Current Social Security provisions to cover new federal employees; current Social Security contribution rates for 1984 and; current pay-off maximums of Social Security Benefits.
- C. Assumptions that the proposed Supplemental Retirement Plan will include same basic provisions as cited in Presidential FY-1984 Budget proposals regarding extending retirement age, imposition of early retirement penalties, and using high-5 year average salary as annuity base.

COMPARISONS OF RETIREMENT OPTIONS AND BENEFITS
Sanitized Copy Approved for Release 2011/01/14 : CIA-RDP89-00066R000900100039-3
Federal Employee Under Current Civil Service
Compared With
Federal Employee Under Proposed Social Security
Coverage and Supplemental Retirement Plan

CASE EXAMPLE: 55 Year Old with 30 Years of Service--Retired as GS-12, Step 5

<u>CURRENT CIVIL SERVICE (CSR)</u>	<u>COMBINED SOCIAL SECURITY AND SUPPLEMENTAL RETIREMENT PLAN (SRP)</u>
Employee Cost - 7% of Salary	Employee Cost - 11.3% (5.7% Social Security and 5.6% SRP) of Salary
High-3 Average - \$30,331	<u>PART I - Supplemental Retirement Plan</u>
Basic Annuity - \$17,061 per year (b) \$ 1,421 per month	High-5 Average - \$28,088 (a)
Penalty for Early Retirement - 0%	Basic Annuity - \$12,640 (c)
Monthly Annuity at Age 55 - \$1,421 per month	Less 50% Penalty for Early Retirement - \$6,320 (d) \$ 527 per month
	<u>PART II - Social Security</u>
	Annual Salary Last Year of Work - \$33,290 (e)
	Eligibility for Reduced Benefits at Age 62 - \$6,108 per year (e) \$ 509 per month
	Eligibility for Full Benefits at Age 67 - \$8,748 per year (e) \$ 729 per month
	Monthly Supplemental Retirement Plan at Age 55 - \$527 per month
	Total Combined Annuity/Social Security at Age 67 - \$1,256 per month

NOTES: (a) A high-5 average salary base for annuity computation rather than high-3 can be assumed based upon the retirement proposals announced by the Administration.
(b) Currently based on 7% employee contributions.
(c) Supplemental Retirement Plan is proposed at 5.6% employee contribution. This can be assumed to produce a reduced basic annuity in proportion to the difference between what the current 7% employee contribution may earn compared to a 5.6% contribution.
(d) Early retirement penalty of 50% of annuity.
(e) Current (1983) maximum annual earnings allowed for Social Security benefit computation is \$35,700. Maximum annuity at age 62 is \$509 per month and maximum at age 65 is \$729 per month. Full benefit age will be extended to age 66 in the year 2009 and to age 67 in 2027. Age 62 for reduced benefits (70% of full benefits) will continue to be retained.

STAT

Sanitized Copy Approved for Release 2011/01/14 : CIA-RDP89-00066R000900100039-3

Page Denied

Next 2 Page(s) In Document Denied

Sanitized Copy Approved for Release 2011/01/14 : CIA-RDP89-00066R000900100039-3